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SUBJECT: Assessment of Legal Implications of an Extension of Export Controls

Attached for your information is a joint State, Defense, Treasury, Commerce paper assessing the legal implications of the proposed extension of export controls with respect to the Soviet Union. This paper responds to action assignment (2) of the February 10 SIG on Poland.

L. Paul Bremer, III
Executive Secretary

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Not referred to DOC.
Waiver applies.

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February 13, 1982

Assessment of Legal Implications of Proposed Extension of Export Controls

INTRODUCTION

This memorandum discusses legal issues raised by proposals to amend U.S. export control regulations with respect to oil and gas production and transmission goods and technology. The proposals call for the extension of the December 30 sanctions against the Soviet Union so as to assert control:

-- over foreign subsidiaries of U.S. firms ("foreign subsidiaries"); and

-- over foreign products of U.S. oil and gas technology exported before December 30, 1981 ("technology products").

This memorandum considers domestic statutory authority for the proposed new controls; conflicts with foreign jurisdictions posed by any such controls; the range of possible foreign government responses; and the risks of litigation in U.S. courts. The conclusions reached on the basis of a review of the Export Administration Act of 1979, as amended, 50 U.S.C.A. app. § 2401 et seq. ("the EAA"), of pertinent foreign laws, and of related regulations and legal principles are shared by the General Counsels of the Departments of Commerce, Defense and Treasury and the Legal Adviser of the

Department of State. The analysis in this memorandum draws heavily from an earlier study prepared under direction of the General Counsel of the Department of Commerce.

CONCLUSIONS

Our general conclusions are as follows:

A. The U.S. has domestic legal authority to assert controls over foreign subsidiaries.

B. U.S. domestic legal authority to assert controls over technology products is questionable. Accordingly, any attempts at legal enforcement action in U.S. courts by the U.S. Government under any rules promulgated with regard to technology products could well fail. A technology exporter or other party seeking injunctive or declaratory relief in U.S. courts to block enforcement of controls over technology products could encounter some procedural barriers which we believe they could overcome and review on the merits would as a result ultimately be available. In any such case, we believe the government would confront significant difficulties in succeeding in its defense.

C. Should foreign governments make the policy decision to frustrate the extension of U.S. sanctions to foreign subsidiaries or to technology products, existing legislation in some countries would provide means either to compel local companies not to comply with U.S. requirements or to hinder

their enforcement by the United States Government. In addition, new or expanded legislation could probably be enacted rapidly if foreign governments had the political will to do so. Furthermore, even in the absence of such legislation, local company law in some countries may permit appointment of receivers or other measures to force non-compliance with U.S. requirements.

I. Domestic Statutory Authority

A. General Background - The EAA is the basic authority for U.S. export controls on goods or technology. The EAA authorizes controls on exports of "[goods or technology] subject to the jurisdiction of the United States or exported by any person subject to the jurisdiction of the United States," where the controls are necessary for U.S. national security or foreign policy purposes.

EAA controls typically involve a legal requirement that an exporter obtain a validated export license from the Commerce Department before exporting particular types of commodities or technical data from the United States to particular foreign destinations. The Executive Branch has legal discretion to grant or deny such licenses in accordance with procedures and timetables specified by the EAA. Particular commodities and technical data and particular destinations subject to controls are identified in commerce Department regulations. These regulations can be amended relatively quickly by administrative action, but not until notice is given to affected parties.*

*Any expansion or extension of export controls for foreign policy purposes must satisfy the EAA's procedural requirements, including consideration of statutory criteria relating to the effectiveness of such controls, consultations with industry and Congress, and a determination that notwithstanding foreign availability of the controlled items, the absence of these controls would be detrimental to U.S. foreign policy. After controls are imposed, the Secretary of Commerce must report to Congress on the consideration of the statutory effectiveness criteria, on the alternative means attempted and on how the controls will further U.S. foreign policy. There is a question as to whether an amendment to the Export Administration Regulations to control technology products would take the form of an extension of foreign policy controls subject to these procedural requirements. However, any such regulatory change would have to meet due process standards (including timely and effect-

The Commerce Department's regulations also require U.S. authorization prior to reexports of certain U.S.-origin commodities and technical data from foreign countries and prior to the export from foreign countries of the products of certain U.S.-origin components and technical data. Such controls are designed to prevent transfers of controlled items to proscribed destinations from countries to which U.S.-origin commodities and technical data have been exported or reexported.

B. Domestic Statutory Authority Over Foreign Subsidiaries - The EAA gives the President power to prohibit or curtail exports by "any person subject to the jurisdiction of the United States." (50 U.S.C.A. app. §§ 2404(a). 2405(a)). The legislative history behind that phrase shows that Congress intended it to cover U.S. owned or controlled foreign companies. The Senate Report accompanying the legislation states that it "would amend the [EAA] to confer non-emergency authority under the act to control non-U.S.-origin exports by foreign subsidiaries of U.S. concerns" (S. Rep. No. 466, 95th Cong., 1st Sess. 6 (1977)).

This Presidential authority was added to the EAA in 1977, with legislative history that it was to be used sparingly in view of international repercussions. The effect of that 1977 amendment has been "to broaden the potential reach of peacetime, non-emergency foreign policy controls to exports by foreign subsidiaries of all products and data (not merely strategic) to

all destinations (not merely the embargoed nations and other Communist countries)." (Abbott, Linking Trade to Political Goals: Foreign Policy Export Controls in the 1970 and 1980s, 65 Minn. L. Rev. 739, 847 (1981)). The authority under the EAA with regard to foreign subsidiaries has been exercised once and never tested in court. Its sole use was pinpointed to provide a contractual excuse for non-delivery of foreign manufactured Levi's uniforms for Moscow Olympics participants (15 C.F.R. § 385.2(d)(1981)).

Controls on exports by U.S.-controlled foreign firms have been imposed by Treasury under the authority of the Trading with the Enemy Act (50 U.S.C.A. app. § 5(b)). The same jurisdictional reach is found in the International Emergency Economic Powers Act (Id. § 1703(a)(1)). In practice, the extraterritorial reach of the Treasury-administered controls, such as the Cuban embargo, has been cut back over the years in the face of foreign government protests and challenges (Compare 31 C.F.R. § 515.541 (1975) with Id. § 515.559 (1981)).

Several foreign governments, including notably France and the U.K., view the United States' assertions of jurisdiction over subsidiaries based in their territories as unjustified invasions of sovereignty contrary to international law. These Governments argue that under both their domestic law and international law, subsidiaries are nationals of the country of incorporation and cannot properly be subjected to foreign economic regulatory jurisdiction.

The U.S. Government has not historically articulated a clear rationale of its claimed right under international law to regulate subsidiaries. The essence of our response would be that U.S. nationals' ownership of locally incorporated foreign investments gives the U.S. rights and responsibility over the investment that make it appropriate for the U.S. to exercise jurisdiction over the foreign subsidiary in cases of significant national interest not involving conduct prohibited by foreign law. This analysis is reflected in the articles relating to jurisdiction in the current draft of the American Law Institute's Restatement (Third) of the Foreign Relations Law of the United States. The draft Restatement suggests a balancing test based on reasonableness in reconciling conflicts of jurisdiction.

Although the legality of U.S. controls over subsidiaries under international law is disputed by some foreign countries, the legislative history of the EAA makes clear that there is authority to assert such controls as a matter of U.S. domestic law, regardless of whatever international law consequences might ensue.

C. Jurisdiction Based on U.S. Origin of Goods or Technology

(1) Basic Authorities and Practices

In addition to authorizing controls over persons subject to U.S. jurisdiction, the EAA also gives the President broad

authority to prohibit, for foreign policy reasons, the export of goods, technology, or other information "subject to the jurisdiction of the United States" (50 U.S.C.A. app. § 2405(a)). The concept of goods, technology or information subject to U.S. jurisdiction is not defined in the statute or its legislative history.

Under the Export Administration Regulations (EAR), the Commerce Department's Office of Export Administration (OEA) has imposed controls on three general types of transactions that occur in foreign countries: (1) certain reexports from such countries of U.S. goods and technology; (2) certain exports from such foreign countries of end products incorporating U.S. parts and components; and (3) certain exports from such foreign countries of products manufactured using U.S. technology.

The EAR do not clearly reflect the particular jurisdictional basis under section 6 of the EAA (that is, whether jurisdiction over persons or over property) underlying particular regulations in this area. Further, the United States does not appear to have publicly articulated its justification under international law for the application of its controls to the foreign transactions described above. Nonetheless, these controls reflect longstanding U.S. practice.

Furthermore, justification may arguably be found under both domestic and international law where the controls involved were established and binding upon the parties at the time of the original export of the U.S.-origin goods or technology.

When such controls are in existence at the time U.S. goods or technology are exported from the United States, U.S. exporters and foreign importers are on notice under the terms of their export licenses, and under the EAR, that the exported items are subject to a claim of continuing U.S. control. In such cases, the United States assertion of jurisdiction over reexports is made at a time when the goods or technology, and at least one of the parties to the transaction (the exporter), remain subject to U.S. territorial jurisdiction.

It must be pointed out, however, that our arguments for such exercises of control do not clearly fall within internationally recognized principles of jurisdiction. Foreign governments such as the U.K. have argued that their nationals' acceptance of U.S. regulatory conditions cannot extend the sphere of U.S. jurisdiction so as to impair the sovereignty of the United Kingdom.

Where controls on foreign transactions are in force at the time of an initial U.S. export, we conclude that the U.S. can make a credible claim to properly exercise jurisdiction over subsequent reexport of U.S. origin goods or other similar foreign transactions under both domestic and international law. However, there can be no assurance that such a claim would be sustained in an international tribunal.

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(2) Foreign Products of U.S. Technology

The export from foreign countries of foreign products produced through the application of U.S. manufacturing technology such as that related to oil and gas transmission and refining poses a more difficult legal question. Unlike controls on the reexport of parts and components described above, the EAR have not expressly reserved the right to subject foreign products of U.S. manufacturing technology to subsequently imposed U.S. controls as for example, over exports from a foreign country to the U.S.S.R. In the case of the proposed extended Soviet sanctions, regulatory control was not imposed prior to the original transfer of the technology. A claim to U.S. jurisdiction over the products of this previously transferred U.S. technology would, as far as we can judge, have to be predicated upon a claim to continuing U.S. jurisdiction over the previously exported technology solely on the basis of its U.S. origin. We are not aware of any support in international law for such a claim. Indeed, the American Law Institute's Restatement (Second) of the Foreign Relations Law of the United States does not recognize U.S. origin of goods or technology as a source of jurisdiction under international law. In this connection the D.C. Circuit recently reiterated in F.T.C. v. Compagnie de Saint-Gobain-Pont-A-Mousson 636 F.2d 1300 (D.C. Cir., 1980) that U.S.

statutes posing potential conflicts with foreign jurisdictional interests must be construed so as to ensure consistency with international law in the absence of a clear contrary Congressional intent.

As a result of these considerations, it is our view that an assertion of retroactive control over products of technology already outside U.S. territorial jurisdiction would be on tenuous grounds legally. We perceive a significant risk that U.S. courts would not uphold a regulation purporting to cover exports of foreign "downstream" oil and gas equipment manufactured using U.S. technology exported prior to the promulgation of the regulations.

II. Conflicts With Foreign Jurisdictions

The assertion of controls over foreign subsidiaries and technology products would pose direct conflicts between U.S. and foreign legal claims to jurisdiction. As previously noted, the U.K. and others deny the United States any legal right to regulate foreign subsidiaries of U.S. parent corporations. The British, and likely the French and other Western governments, also deny the right of the U.S. to assert controls over property or technology on the basis of its U.S. origin, even where the controls were in effect at the time such property or technology was originally exported from the U.S.

Moreover, private parties suffering economic injury as the result of extended U.S. controls, or subjected to sanctions for their violation, might have an incentive to contest their legality. Subsection B of this section accordingly assesses the possible legal responses of exporters or other private parties which wished to thwart or contest extended U.S. controls.

A. Responses by Foreign Governments - Foreign governments which deny and decide to contest the legality or propriety of applying particular U.S. export control measures within their territory would have a range of possible responsive legal measures.

-- Such governments could make monetary claims under public international law against the U.S. for economic injuries alleged to flow from wrongful U.S. conduct. However, such international claims would not have any immediate impact to block or interfere with the operation of U.S. controls. Any such claims would be unprecedented. The essence of such claims would be either that the U.S. had wrongfully inflicted an injury on nationals of the complaining state through its controls, or that the controls gave rise to an expropriation requiring prompt, adequate and effective compensation under international law.

We are not, at this point, able authoritatively to assess the legal risks of such hypothetical foreign government claims. However, such claims would be novel, and there is

little authoritative international law or state practice to support them. Accordingly, we are inclined to conclude that such claims would not involve significant legal risks to the U.S. However, the final resolution of any such claims through diplomatic adjustment, arbitration, or dispute settlement procedures could take years.

-- More immediately, foreign governments could take action, or permit or facilitate private parties' actions, to block application of the U.S. controls. For example, there are existing statutes in the U.K. and France that could impede or prevent enforcement of U.S. controls. The British Protection of Trading Interests Act is the most notable example of such blocking statutes. That Act authorizes the U.K. Secretary of State for Trade to issue orders barring companies that trade in Britain from complying with foreign legal requirements if those requirements are damaging or threatening to damage U.K. trading interests (Protection of Trading Interests Act, 1980, c. 11, § 1). Such a statutory provision could be used to prevent compliance with the proposed U.S. oil and gas export controls.*

*Such foreign orders compelling parties in foreign jurisdictions to perform acts prohibited by U.S. law could make enforcement of the U.S. regulations concerned in U.S. courts or administrative proceedings problematic. A foreign firm, lawfully compelled by its government officials or its courts not to comply with U.S. controls within the territory of the foreign state concerned could well be found subject to a defense analogous to the sovereign compulsion defense under antitrust law. See 1 J. Atwood & K. Brewster, Antitrust and American Business Abroad, 265 (1981); Restatement (Second) of Foreign Relations Law of the United States § 40 (1965); U.S. Dept. Of Justice, Antitrust Guide for International Operations 55 (1977).

Even if other countries do not attempt to frustrate the successful implementation of the proposed oil and gas controls, they may hinder U.S. enforcement actions against offending firms operating in their countries. Many countries have legislation that would prevent disclosure of information to foreign enforcement officials. Some of these statutes would impose criminal liability on U.S. nationals, including U.S. government officials, seeking documentary evidence or testimony in a foreign country to support an alleged violation of the oil and gas controls (See, e.g., Law No. 80-538 [1980] J.O. 1799 (France); S. & GB, C.P., Code Pen. § 271 (1971)(Switzerland)).

Blocking statutes are not universal, and some are quite limited in scope. (The German statute, for example, is limited to discovery in shipping matters.) Whether particular governments could or would enact additional statutes to thwart objectionable U.S. controls involves political judgments outside the scope of this paper. However, in the past, blocking statutes have sometimes been enacted with great speed in order to meet objectionable U.S. claims to jurisdiction. The New Zealand statute, which is modeled upon the 1980 British Protection of Trading Interests Act, was enacted in less than one week in response to a U.S. antitrust investigation. Once enacted, these statues may confer rights on the foreign government or on private parties which could hinder the achievement at a later time of U.S. objectives which are less controversial or more easily justified under international law as being within U.S. jurisdiction.

-- Finally, even in the absence of foreign blocking legislation, a foreign court or other institution may intervene in a company's management to block its compliance with a U.S. requirement. In 1965 this occurred when the French courts in the Fruehauf case removed a foreign subsidiary from the U.S. parent's control and thus from U.S. jurisdiction -- at the request of the French minority directors. The result was that U.S. controls against trade with the People's Republic of China by foreign subsidiaries of U.S. companies were circumvented. (Fruehauf Corp. v. Massardy, (1965)La Semaine Juridique II 14274 (bis)(Cour d'appel, Paris), (1965) Gaz. Pal. II 86, 5 Int'l Legal Mat'ls 476, reprinted in A. Lowenfield, Trade Controls for Political Ends § 3.3 at 81 (1977)).

It is not possible to foresee all the legal means which a foreign government might use to respond to U.S. controls which it found objectionable. In all cases, it is safe to assume that determined foreign governments could resort to or devise legal, regulatory or administrative means to discourage local firms' compliance with U.S. requirements or to discourage information gathering related to enforcement.

The United States could respond to these potential foreign reactions by suspending the U.S. export privileges of foreign firms violating U.S. controls (15 C.F.R. §§ 387.1(b), 388.3 (1981)). The suspension can be achieved through administrative hearings and would not require the gathering of evidence abroad.

Such U.S. sanctions might induce a foreign company that is dependent upon continued access to U.S. goods and technology to persuade its government not to impede compliance with controls. Such unilateral action on our part could result in retaliation against U.S. firms and other disruptions or disincentives to future U.S. export trade, but the likelihood or extent of such trade effects are outside the scope of this memorandum.

B. Measures by Private Parties - Judicial Review -

There are at least two sets of circumstances in which private parties affected by new U.S. controls might seek judicial review. Such review could go to the authority of the President or the Commerce Department under the EAA or the Constitution to impose particular controls; to a claim that the controls were unconstitutionally imposed (e.g., lack of due process, arbitrary and capricious); or to an assertion of some other procedural defect or infirmity.

First, in defense to administrative enforcement procedures by the Department of Commerce or to criminal proceedings in the U.S. courts, a private party could raise insufficiency of statutory authority or procedural defects as defenses. Such defenses would clearly be available in criminal proceedings. The situation is less certain in the case of judicial review of Commerce Department administrative sanctions. The EAA does not provide for judicial review of administrative

sanctions imposed by the Commerce Department and we know of no case in which the reviewability of such sanctions has been litigated.

Nevertheless, we believe it likely that a private party would be able to obtain judicial review of sanctions imposed under a regulation alleged to be ultra vires and invalid. Such a claim could be framed as a constitutional claim of denial of due process. The courts would be unlikely to construe the EAA to bar judicial review of such a constitutional claim, see Weinberger v. Salfi, 422 U.S. 749, 762 (1974); Johnson v. Robison, 415 U.S. 361, 366-67 (1974).

Alternatively, a private party adversely affected by extended controls could affirmatively seek injunctive or declaratory relief on the basis of the claims described above. In that event, a potential plaintiff would face three possible hurdles, all of which we believe could be overcome -- standing, exhaustion of administrative remedies, and ripeness.

In order to establish standing, an exporter or other plaintiff would have to show that it has been injured in fact by the extension of controls and that the interest sought to be protected is arguably within the zone of interests to be protected or regulated by the statute or constitutional guarantee in question. Association of Data Processing Service Organizations v. Camp, 397 U.S. 150, Barlow v. Collins, 397 U.S. 159 (1970).

A prospective plaintiff would encounter a threshold problem in this regard because section 13 of the EAA excludes "functions exercised under this Act" from the operation of major provisions of the Administrative Procedure Act ("APA") (5 U.S.C. § 551-553, 701-706). Section 702 of the APA made it considerably easier for a plaintiff to establish standing to bring legal action against an agency by providing that "[a] person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute" is entitled to judicial review thereof.

However, a prospective plaintiff could argue that he was entitled to APA review on the theory that in promulgating an ultra vires regulation, the Department of Commerce was not exercising a "function under" the EAA, and the section 13 exclusion did not apply.

We believe this argument would likely be persuasive to a court. Even if it should fail, however, potential plaintiffs could argue for standing on the basis of a claimed denial of constitutional protection, Cramp v. Board of Public Instruction, 368 U.S. 278 (1961).

If standing were found, a plaintiff would be faced by the normal administrative law requirement of exhaustion of remedies. This principle could require application for an export license; executive inaction or refusal on such application within

the time periods specified by the EAA; and exhaustion of the appeal procedures specified by the EAA. Rigorous enforcement of the exhaustion of remedies requirement could delay the opportunity for judicial review of any extended controls for several months.

However, it seems doubtful that a court would require exhaustion of remedies where that would be a useless act. The Government's licensing policy, publicly laid down by the President in his December 29 statement, and in the Commerce Department General Order suspending all licensing for export to the Soviet Union (47 Fed. Reg. 144 (1982)), is that export licenses will not be granted. Thus, it would be pointless to require exhaustion of remedies since relief will not be available through administrative action. Moreover, courts will not require exhaustion of remedies where a plaintiff argues that an agency has acted beyond its statutory authority by issuing orders or regulations which are plainly invalid on their face. Skinner & Eddy Corp. v. U.S., 249 U.S. 557 (1919).

If both standing and subsequent exhaustion of remedies were found, a plaintiff would have to show that the issue presented was ripe for judical determination. The key question here would be whether a plaintiff could properly challenge the extension of export controls before any enforcement action was taken against it. Courts have at times looked upon requests

for injunctive or declaratory relief prior to enforcement action as premature, but it is now well settled that administrative regulations may be reviewed prior to enforcement, provided that the suit presents issues appropriate for judicial determination. Such issues would include where an agency is accused of exceeding its statutory authority, and the regulations in question require an immediate and significant change in plaintiff's conduct with serious penalties attached to noncompliance Abbott Laboratories v. Gardner, 387 U.S. 136 (1967). Plaintiffs whose export transactions are suddenly precluded by an extension of export controls would in our judgment appear to satisfy these requirements.

2/13/82